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Economists & Liberty:

Ludwig von Mises (1881-1973)

By Peter Boettke

Friends of liberty for a long time have recognized the intimate connection between economic and personal liberties. Among modern economists this message has been heard from either one of two sources: the Chicago school economists, foremost among them being Milton Friedman; or the "Austrian" economists, most notably Ludwig von Mises, F. A. Hayek, Ludwig Lachmann, Israel Kirzner and Murray N. Rothbard. In this series of six essays, I plan to introduce the reader to the writings and thoughts of the modern Austrian school, including recent developments in my concluding essay. My exclusive concentration on the works of writers within the Austrian tradition reflects my opinion that it is in these works that the case for economic freedom has been most forcefully put forward. I would like to recommend, however, Friedman's *Capitalism and Freedom* (University of Chicago, 1982) to anyone interested in the defense of political and economic liberty.

Ludwig von Mises serves as the perfect starting point for any discussion of the modern Austrian School of Economics. Not only did Mises serve as the guiding intellectual force in defining the Austrian paradigm, he was also the great teacher of future generations of economists, historians and social thinkers. Mises' influence as a teacher spanned across two worlds, the Vienna of the 1920's and 1930's, and the U.S. in the 1940's, 1950's and 1960's. Among his students are some of the greatest names in economics in the 20th century - Gottfried Haberler, Fritz Machlup, Oskar Morganstern, and Lionel Robbins to name a few besides Kirzner, Hayek and Rothbard; as well as important figures in other disciplines - Alfred Schutz and Felix Kaufman to name two.

Mises had the ability to instill in his students not only the interest in correct economic thinking, but also a love of liberty. Even those students of Mises whose contributions have been in realms other than abstract theoretical economics have been stalwarts in the battle of economic and political freedom. Such individuals as Robert Anderson, Percy Greaves, Bettina Bien Greaves, Henry Hazlitt, Leonard Liggio, Ralph Raico, George Reisman, Louis Spadaro and my own undergraduate teacher, Hans F. Sennholz, have been unyielding in their efforts to advance the cause of freedom, both in their writing and their teaching.

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It is precisely in the fact that Mises was not only one of the greatest minds ever to be concerned with economic science, but also a great teacher, that his influence will live on. His combination of the cool reasoning of an economic genius with the passion of a revolutionary was unique in this century, where academic success required being an ideological eunuch. Because of his ability to teach others the importance of economic and political freedom, Mises was able to set in motion the modern libertarian movement, both at the level of high-theory and at the level of the layman.

Ludwig von Mises received his doctorate of law and economics from the University of Vienna in 1906, and began a career as one of the most prolific scholars that economics has ever known. When he retired from teaching in 1969, at the age of 88, he had written 16 books, and published hundreds of articles and essays, not including translations into foreign languages. While most great thinkers in the history of economic thought produce one milestone work within their lifetime, Mises produced three great books.

His first major work, *The Theory of Money and Credit* (Liberty Press, 1980 [1912]), applied the concept of marginal utility to money and successfully bridged the gap between price theory and monetary theory. Mises, building on the work of Carl Menger, demonstrated that money emerges naturally on the market as individuals engage in exchange and production activities. As the division of labor increases, individuals find it in their interest to enter indirect exchange activity, exchanging those goods they produce for more marketable goods which they will, in return, exchange for the goods they want. By entering this process of indirect exchange,

individuals avoid the problem of the double-coincidence of wants associated with barter, and are able to increase their specialization and reap gains from trade. Eventually, one good emerges out of this process as the most marketable, and that good becomes the generally accepted medium of exchange, i.e., money. The Misesian "Regression Theorem", moreover, demonstrated that the value of this medium of exchange is ultimately derived from its original value as a consumption commodity on the market. In other words, money must emerge out of the interplay of market activity and cannot be imposed on the market system by decree. Thus, Mises showed that all attempts at establishing a fiat currency will result in monetary instability and disrupt economic calculation.

In addition to Mises' discussion of the essence of money, *The Theory of Money and Credit* was where the "Austrian" theory of the trade cycle was first developed. The trade cycle, according to this theory, is but one instance of the more general inflation process that takes place whenever the money supply is increased. Mises pointed out that monetary expansion does not raise all prices at once, as a mechanical interpretation of the quantity theory of money would suggest, but rather, money works its way through the economic system starting at the point of injection and causing changes in relative price as it is filtered through the system. This process, therefore, 'benefits' the early recipients of the 'new' money at the expense of those last in line.

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Monetary expansion at the time Mises wrote was generally accomplished through credit expansion by the banking system. *The Theory of Money and Credit* analyzed how credit expansion artificially lowers the interest rate, leading businessmen to invest in long-term projects that otherwise would not have appeared profitable. The resulting distortion in the structure of production eventually cannot be maintained as the monetary expansion works its way through the economy. Consumers continue to draw incomes and reassert their "true" preferences for savings/consumption. The interest rate adjusts to reflect the real scarcity of savings, in comparison to producers' perceptions after credit expansion, leading to the collapse. Those projects which appeared profitable no longer do, and businessmen shift their resources elsewhere. The "boom" associated with credit expansion, therefore, leads to the "bust" when economic forces reassert themselves. Mises, applying this theory to analyze the world monetary order of his time, was able to "predict" the monetary collapse of the late 1920s and 1930s, something which modern economists, both Keynesians and Monetarists, have yet to figure out.

World War I took Mises away from active research for a few years, while he first did duty on the front and then later (1917) worked in the economics division of the Department of War. In 1919, however, he published *Nation, State and Economy* (New York University Press, 1983), a stinging criticism of "War Socialism" and the ideas of National-Socialism. Mises claimed that it was his wartime experience that led him to raise fundamental questions of economic and social policy, questions about whether capitalism, socialism or interventionism constitute suitable systems of social cooperation.

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In 1920, Mises began what was to become his second great contribution to economic science. The publication of "Economic Calculation in the Socialist Commonwealth" triggered the Grand Debate in economic theory over capitalism and socialism (c.f., F. A. Hayek, *Collectivist Economic Planning*, Routledge & Sons, 1935; and Don Lavoie, *Rivalry and Central Planning*, Cambridge University Press, 1985). Mises developed his argument for capitalism further in his 1922 publication, *Socialism: An Economic and Sociological Analysis* (Liberty Press, 1981). He challenged socialist thinkers to overcome their taboo against analyzing the economic organization of the future socialist world and grapple with the problems of economic calculation.

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The popularity of the socialist vision, which sought to eliminate private property in the means of production and substitute for the market a comprehensive central plan, was on the rise in the early 1920s due to the optimism of Western intellectuals concerning the Bolshevik revolution. Against this spirit of collectivism, Mises offered his challenge that rational economic calculation under socialism was impossible in an advanced industrial economy. He argued that without private ownership of the means of production, a market for the means of production would not exist. Without this market, there would not be money prices for the means of production.

And without money prices for the means of production, rational economic calculation would not be possible. Money prices, according to Mises, emerged as the unintended outcome of the voluntary interaction of a multitude of individuals pursuing their separate and often conflicting plans in a market setting. The prices that emerge in the market convey general knowledge about the relative scarcities of particular goods, and thus serve as "aids to the human mind" for rational calculation. In the absence of a market for the means of production, Mises asked, how would the Central Planning Board *know* which projects were economically feasible and which ones were not?

Socialism, however, was a book that moved beyond the realm of technical economics and made a lasting contribution as a sociological study. Mises compared and contrasted his vision of classical liberalism with socialism, and provided an exemplar of how to study comparative economic systems. Mises' systemic approach toward comparative political economy was reinforced in the 1920s with the 1927 publication of *Liberalism: In the Classical Tradition* (Foundation for Economic Education, 1985), which set out and defended his positive vision of social cooperation under liberal institutions, and the 1929 publication of *A Critique of Interventionism* (Arlington House, 1977), which pointed out the fallacies and contradictions involved in coercively intervening in the price system by pursuing policies such as wage or price controls.

Mises also continued working in monetary theory during this time. In 1926, he helped establish the Austrian Institute for Business Cycle Research. Mises' papers and booklets on monetary disturbances have been collected and edited by Percy Greaves, *On the Manipulation of Money and Credit* (Free Market Books, 1978). This volume contains several classic studies by Mises of the undesirable consequences that follow from political manipulation of the money supply, that had hence forth been untranslated. Mises' concern with monetary order is echoed throughout his scholarly life and can perhaps be represented in the following analogy. Imagine a well-shaped wheel, which represents an integrated capitalist structure of production, the spokes of the wheel represent prices and the hub of the wheel represents money. Playing around with the spokes will distort the shape of the wheel, but if the hub is played around with too much, the wheel can be destroyed. The 1920s and 1930s was a time when both men of action and men of ideas sought to either increase the size of the wheel by expanding the hub (the Federal Reserve Bank in the 1920's, and Keynesian economists from 1930s - 1970s) or create a new kind of wheel by eliminating the hub altogether (Lenin, Bukharin and the Bolsheviks during "War Communism," 1918-1921). Neither group, though, understood the nature of the wheel, i.e., the structure of production under capitalism. Mises found himself having to turn to fundamental questions of capital theory, epistemology and the methodology of the human sciences to clarify his position.

Epistemological Problems in Economics (New York University Press, 1981 [1933]) collected essays by Mises which for the first time explicitly defended his methodological approach to the human sciences. Within these pages he also made significant advances on his "masters", Menger and Eugene Boehm-Bawerk, both in value theory and capital theory. Particularly interesting, from a methodological perspective, are Mises' critical discussions of Max Weber, and the fundamental insights into the roles of cognition (theory) and understanding (history) in the sciences of human action.

With the rise of Hitler, Mises left Vienna for Geneva, Switzerland. From 1934-1940, he taught as a professor of International Economic Relations at the Graduate Institute of International Studies in Geneva, and finished the German edition of magnum opus, *Nationalökonomie: Theorie des Handelns und Wirtschaftens* (The original German version which was revised to be *Human Action*). Mises emigrated to the U.S. with his wife, Margit in 1940 (c.f., Margit von Mises, *My Life with Ludwig von Mises*, Center for Futures Education, 1984). Unable to find a suitable university position because of ideological currents, Mises, supported by small foundation grants, wrote two masterful studies. *Bureaucracy* (Arlington House, 1969 [1944]) and *Omnipotent Government* (Arlington House, 1969 [1944]) analyzed, respectively, the economic consequences of bureaucratic organization, and the rise of Nazism and the economic policies of National-Socialism. In 1944, Mises began his American teaching career as a Visiting Professor of Economics at the Graduate School of Business, New York University.

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It was at this time that Mises began to re-work his treatise on economics. *Human Action* (Henry Regnery, 3rd. rev. edition, 1966) restated and extended his earlier work in economics, and is quite simply one of the greatest achievements of the human mind in the 20th century. Mises systematized the science of "praxeology" and refined the principles of its most developed branch, economics. The work is a masterpiece in the history of thought, criticizing and incorporating the insights of the great minds that came before; and in original research, as Mises derives insights that had henceforth been unknown to social thinkers. He demonstrated that for sound economic reasoning, the social scientist must seek to understand and interpret economic phenomena in terms of purposive human action, i.e., the fact that individuals have goals and arrange their actions to

attain them. Beginning with reflection upon the essence of human action, Mises derived the fundamental principles of economic science and applied them in analyzing the nature of the market system, monetary theory, comparative economic systems, and the relationship between economic and political freedom.

Reading *Human Action* is both an intellectual challenge and an emotional experience. Mises' passion for individual liberty is intertwined with razor-sharp economic analysis. His economic approach was humanistic, his concern was humanitarian. "Economics," Mises argued, "must not be relegated to classrooms and statistical offices and must not be left to esoteric circles. It is the philosophy of human life and action and concerns everybody and everything. It is the pith of civilization and of man's human existence" (1966, p. 874).

Mises wrote a few other books after *Human Action*, most notably two methodological tracts critical of the positivistic philosophy of the social sciences, which has dominated economics since the 1930's. *Theory and History* (Mises Institute, 1985 [1957]) and *The Ultimate Foundations of Economic Science* (Sheed, Andrews and McMeel, 1978 [1962]) demonstrated the flaws of the positivistic attempt to apply the methodology of the physical sciences to the human sciences, and argued for the unique character of the human sciences, which Mises maintained began with acting man.

Mises' last pamphlet, *The Historical Setting of the Austrian School* (Mises Institute, 1983 [1969]) is an excellent discussion of the development of the early Austrian school, and is recommended reading to anyone interested in the intellectual and cultural climate out of which Mises' ideas emerged. I have limited myself to discussing, in very superficial terms, the major theoretical contributions of Mises. His ideas will be clarified further in the following essays as I trace how the other Austrian economists, Hayek, Lachmann, Kirzner, Rothbard and several young 'Austrians', are critical of some aspects and build upon others in the Misesian system.

Mises, besides being the scholarly academic was also an active essay writer on political and economic freedom for the more general audience. Two excellent collections of his popular essays can be found in *Planning for Freedom* (Libertarian Press, 1980) and *Economic Policy* (Gateway, 1985).

Ludwig von Mises, both as a scholar and teacher, serves as a guiding light in the advancement of freedom. He passed the torch to the next generation, it is our duty to carry it as highly and proudly as he did.

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